

# MSDA

## Michigan Soft Drink Association

Telephone: 517/371-4499  
Facsimile: 517/371-1113  
msda@voyager.net

124 West Allegan Street, Suite 634  
Lansing, MI 48933-1707

William E. Lobenherz, President  
and Chief Executive Officer

February 19, 2008

### OFFICERS AND DIRECTORS

**Chairperson**  
**Lee Scott**  
Coca-Cola Bottling  
Company of Michigan

**Secretary/Treasurer**  
**Nick Geswein**  
Cadbury Schweppes  
Bottling Group

**Vice Chairperson**  
**Tim Matson**  
Pepsi-Cola Company  
of Michigan

**DIRECTOR EMERITUS**  
Robert Bink  
Robert Healy  
William Kreger  
Jack Shanker  
J. Dean Templeton  
H. Duane Tirschel

The Honorable Steve Bieda  
Michigan House of Representatives  
PO Box 30014  
Lansing, MI 48909

Re: SB 5734 - 37

Dear Representative Bieda:



We appreciate your initiative to have the House Tax Policy Committee move forward with some of the technical amendments to the newly enacted Michigan Business Tax, and we wish to express our support for the referenced HB5734, HB5735, HB5736, and HB5737.

Our interest in the bills before your Committee relates to the treatment of foreign dividends/royalties in gross receipts, as well as the recognition of Puerto Rico as a foreign entity.

The attached document explains in more detail the rationale behind these technical changes. We believe you will find these changes to be non-controversial, with negligible if any impact on estimated revenues.

Thank you in advance for your consideration.

Sincerely,



William E. Lobenherz

WEL:jg

Cc: House Tax Policy Committee Members  
Michigan Legislative Consultants

Enclosure

## MICHIGAN BUSINESS TAX PROPOSED CHANGES

### Definition of Foreign Operating Entity

In order to qualify for the "foreign operating entity" exclusion, a company is required to have substantial operations outside the United States.

However, under the current definition, operations in Puerto Rico and US possessions are specifically designated as being *inside* the United States.

There are a number of reasons why these operations should be considered "foreign" for purposes of the definition:

- Significant federal tax changes went into effect in 2006 for Puerto Rican operations, which required changes to their corporate structure. Under current federal tax laws, companies can elect to place their Puerto Rico and other US possession operations into either a US company or a foreign company. A vast majority of companies have converted their Puerto Rico/US possession operations to the foreign entity structure. Under such structure, Puerto Rico/US possession operations are excluded from the Michigan Business Tax because only US companies are included in the combined report. Therefore, an inconsistency in tax treatment exists for the very small group of companies which placed these operations in a US affiliate. These companies are being treated differently than most other companies which are able to exclude their Puerto Rico/US possession operations from the MBT.
- The current treatment of the Puerto Rico/US possession operations is also contrary to federal tax law which considers Puerto Rico/US possessions for income sourcing rules as being outside the United States. Most other IRC provisions accord similar treatment.
- The federal tax foreign sourcing rule is followed in all other States. Moreover, all States with combined reporting which exclude foreign operating companies (most combined reporting States) consider Puerto Rico/US possessions as being outside the United States.
- There should be no revenue loss to treat Puerto Rico/US possession operations as foreign. First, none of these operations were included in SBT revenues. Moreover, because a vast majority of companies operate their Puerto Rico/US possession businesses through foreign companies, these operations are already excluded from the MBT.

## MICHIGAN BUSINESS TAX PROPOSED CHANGES (cont.)

### Gross Receipts Exclusion for Foreign Dividends/Royalties

In the definition of "gross receipts", no exclusion is provided for dividends and royalties received from non-U.S. persons and foreign operating entities. By including this income in the gross receipts portion of the MBT, Michigan is taxing receipts from foreign operations. This treatment is inconsistent with the net income component of the MBT, which excludes such income, and contradicts the general intent of the MBT to tax only on a US "water's-edge" basis.

Because US parent companies are generally the only entities which receive receipts from foreign dividends and royalties, without an exclusion, the MBT places our US companies at a commercial disadvantage with foreign parent companies. The MBT law should be amended to incorporate an exclusion for such income in the gross receipts component similar to the deduction in the income tax.